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August 20, 2003

Eric O. Stanchfield, Secretary
Trustees of the Employee Trust Funds Board
Department of Employee Trust Funds
P.O. Box 7931
Madison, WI 53707-7931

Dear Secretary Stanchfield and Trustees:

Subject: Internal Audit Biennial Report of Audits and Advisory Services, July 1, 2001 - June 30, 2003

At the completion of each biennium, Internal Audit issues a report on audit activities. For most audits Internal Audit issued a formal report to the Secretary's Office and distributed copies to the ETF Board. For business advisory services Internal Audit usually did not issue a formal report. All are included in this report. *Please note: This report is informational only. No action is required.*

DETF Risk Management and Internal Control Standards: In the early 1990s, most managers received internal control training. Management then asked Internal Audit to develop easily understood "DETF Internal Control Standards." Standards were designed to meet objectives of the 1992 Treadway Commission report: "Internal Control - Integrated Framework" from the Committee of Sponsoring Organizations - better known as COSO. This landmark report, issued following the savings and loan crisis of the 1980s, changed management awareness of risks related to weak internal controls. COSO identified five basic control components: control environment, risk assessment, control activities, monitoring, and information and communication – the link among all other components.

After the Enron and WorldCom failures, the COSO group came together again to revitalize the concept of risk. The COSO report, "Enterprise Risk Management Framework" will be final in 2004.

DETF Environment: DETF continues to become more "data driven," relying increasingly on automated systems to effectively carry out responsibilities. Automation provides opportunity for efficiencies but changes the ability to manage risks and adequately safeguard trust fund assets; information security and continuous auditing and monitoring of data system integrity become more important. Internal Audit priorities attempt to focus on areas of greatest risk and exposure within this changed environment. To this end, Internal Audit is currently coordinating a Department-wide risk assessment with input from managers at all levels. This is discussed in the report.

Respectfully submitted,

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**DEPARTMENT OF EMPLOYEE TRUST FUNDS
INTERNAL AUDIT BIENNIAL REPORT
2001-2003**

A. AUDITS: REPORTS ISSUED OR FIELD WORK IN-PROCESS:

1. Enumeration Verification System Audit of Annuitant Accounts:

Internal Audit matched data for active annuitants with the Social Security Administration (SSA) Enumeration Verification System (EVS) and completed follow-up to obtain information to facilitate the correction of inaccurate information. Report 2002-1

2. Manual Warrant and Journal Voucher Approval Audit:

The Department Deputy Secretary requested this annual audit as a compensating control. Internal Audit reviewed all vouchers because of limited segregation of responsibilities. Procedural changes created additional segregation of responsibilities, eliminating the need to complete this audit in the future. Report 2002-2

3. IRS Minimum Distribution Audit:

Internal Audit tested Member Services' automatic distribution at age 70 ½. This included research and testing of Special Death Benefit changes in statutes/rules. Report 2002-3

4. Enumeration Verification System Audit of Named Survivors (Phase 1) High Risk Records:

Internal Audit matched data for named survivors with the SSA Enumeration Verification System (EVS) and followed up to obtain information to facilitate the correction of inaccurate information. Report 2002-5

5. Monthly Death Match Audit of SSA Reported Deaths:

Internal Audit continued monthly out-of-State death match audits and provided results to Benefit Payments for follow-up. This report summarized results for a 2½-year period. Report 2002-6

6. Analysis of Changes to Annuity and Single Sum Benefits (Pilot):

This was the first part of a test audit to begin development of an annual integrity review of all accounts. This audit addressed in part a concern first expressed by DETF—IA and later by LAB about powerful access authorities given to ETF programmers. LAB suggested a review of account records for all ETF programmers. IA concurred this would be a reasonable test, but suggested the test include all ETF employees and former employees, with the final objective to review changes to all accounts, not just DETF employee records. Reason: Only a full file analysis will address DETF's vulnerability related to access security. The second part of the test audit is discussed below under number 9. Report 2002-7

7. Enumeration Verification System Audit of Named Survivor Data (Phase 2):

Internal Audit matched data for named survivors with the SSA Enumeration Verification System (EVS) and followed up to obtain information to facilitate the correction of inaccurate information. Report 2002-8

8. Match of Annuitant Data to Social Security Administration (SSA) Death Master File:

This was a control to assure that the monthly update process did not bypass deaths reported previously by SSA. Report 2003-1

9. Analysis of Annual Changes to Member Account Balances (Pilot):

This was the second part of a test audit to begin development of an annual integrity review of all WEBS Statement of Benefit Account balances. This audit addresses in part a concern first expressed by DETF - IA and later by LAB about powerful access authorities given to ETF programmers. LAB suggested a review of account records for all ETF programmers. IA concurred this would be a reasonable test, but suggested the test include all ETF employees, with the objective to review changes to all member accounts, not just accounts for DETF employees. Reason: Only a full file analysis will address DETF's vulnerability related to access security. Report 2003-2

10. Enumeration Verification System Audit of Inactive Accounts:

Internal Audit matched data for inactive DETF member records with the Social Security Administration Enumeration Verification System (EVS). These accounts (often lost contacts) are a higher risk exposure to DETF. Report 2003-3

11. In-Process Audits:

- a. Controls for Closing Inactive Account Balances: This is an internal control audit involving the processes for three different DETF Divisions/Offices: Retirement Services, Employer Services, and the Controller's Office.
- b. Annual Changes in WEBS Account Data - Statement of Benefit: This is the ultimate objective of audit report 2003-2 described in 9 above.
- c. Re-issue of Stale Dated Checks: Stale dating refers to checks that become void one year after being issued. This is a review of internal controls for re-issue of such checks.
- d. Custom File Maintenance: This is an internal control review of the DETF process for making changes to automated DETF records when no IT application program is available.

B. MANAGEMENT ADVISORY SERVICES / TECHNICAL ASSISTANCE:

1. Department-wide Risk Assessment:

To address constantly changing risks and limited resources, DETF is working toward risk management at the enterprise level. Part of risk management is risk assessment, a process that identifies areas of highest risk coupled with the likelihood and consequence of occurrence. Retirement Services, the largest DETF division, recently completed a risk assessment and we submitted a report to the Secretary's Office. When all Divisions and Offices have completed the risk assessment, we will merge the information and issue a final report to the Secretary's Office and share it with the DETF Board. Once completed across all levels of management, the risk assessment will be updated annually.

2. Locating Lost Contact Members:

Internal Audit coordinated a June 2002 test and assisted in securing a license of an on-line locator service for 5 concurrent users. Use of the service has reduced published lost contacts substantially. Subsequently, IA provided additional advisory services in locating lost contacts. This included assistance in re-instituting possible use of SSA Letter Forwarding and Out-of-State Offices of Vital Statistics (Report 2002-4). As evidence of how Out-of-State Offices of Vital Statistics could be used, IA was able to locate the beneficiary of a published lost contact member with a vested account balance in excess of \$100,000. This amount has since been paid to the only surviving next of kin of the deceased member.

3. Development of Security Monitoring Process:

As follow-up to the 1997 Computer Maintenance Controls Audit, Internal Audit continues to provide assistance and advice on needs for the security monitoring process developed by the Computer Science Bureau in FY 2001 and reported on to the ETF Board in Report 2001-3.

4. Benefit Payment System (BPS) Advisory Services:

- a. Provide information to scope the work of the BPS Project Monitor to include addressing major risks and control weaknesses identified in the 1997 Computer Program Maintenance Controls Audit.
- b. Provide informal advice related to IT access security risks for contractual service vendors.
- c. Provide advice for the demographic database from data clean-up audits (e.g. SSA Enumeration Verification System).
- d. Provide advice on data anomalies and system needs identified during audits. For example, a 1997 audit showed procedures were not in place to consistently identify and validate payments to annuitants in foreign countries where payments after death are a higher risk. This audit identified data needs that will reduce that risk. (Number: 2001-7 – issued internal only).

5. Department Documentation and Records Retention Activities:

- a. Coordination of Department Procedures: Advanced Auditor Vicki Wickiffe continues to coordinate and provide training on ETF Procedures, articulating the risk related to expected turnover of employees in key positions who will retire. The issue of turnover of ETF staff was added to ETF Strategic Planning and a procedure development goal was articulated to address the risk.
- b. Records Disposal Authorizations: Audit Director and IT Auditor Helen Malzacher have worked to upgrade IT record retention improvements, advising on:
 - A process to identify/add/change/delete electronic files to appropriate RDA's.
 - ACT 11 RDA process
 - Technical, analytical, and documentation processes to follow for legislative, strategic, and annual changes that affect ETF data and programs (e.g. WEBS interest crediting).
- c. WEBS User Team Flowcharts: Advanced Auditor Gail Cartter prepared flowcharts on WEBS daily reconciliation procedures to be used to supplement written procedures for critical daily, monthly, and year-end processes.

6. Other Advisory Services:

- a. Processing and Payment Risks for ACT 11 Deceased Annuitants: Internal Audit analyzed and reported on risks of a process that utilized the existing Annuity Payment System.
- b. Inactives Address Match: At the request of management, Internal Audit analyzed the National Change of Address (NCOA) register to determine the utility of NCOA for locating Lost Contacts or other purposes. This provided additional support for implementation of the on-line Locator Service.
- c. Access Security: Internal Audit provided advice on Changes to Access Security for beneficiary designation changes related to death benefits.

C. OTHER INTERNAL CONTROL AND GOVERNANCE RELATED ACTIVITIES:

1. Public Pension Fund Benefit Administration Key Risk Document:

Vicki Wickliffe, DETF Advanced Auditor, was Co-chair of the Association of Public Pension Fund Auditors (APPFA) committee that developed this document. The document is expected to receive endorsement from the Government Finance Officers Association (GFOA), the National Association of State Retirement Administrators (NASRA), and the National Council on Teacher Retirement (NCTR). These three organizations previously endorsed APPFA's Investment Risk Document.

2. Whistle-Blower:

The Internal Audit Director is ETF's Contact. There were no reports during the past 2 years.